Long v. Commissioner, 93 T. C. 5 (1989)

Under Rev. Proc. 65-17, actual payment in cash or a written obligation is required to avoid tax consequences of section 482 allocations.

Summary

In Long v. Commissioner, the U. S. Tax Court held that the taxpayer, William R. Long, and his controlled corporations did not comply with the terms of a closing agreement under IRS Revenue Procedure 65-17. The agreement required Long Specialty Co. , Inc. to pay Long Mfg. N. C. , Inc. within 90 days following a section 482 allocation. Despite having the financial ability, no actual payment was made within the stipulated time. The court ruled that an actual transfer of funds was necessary to avoid tax consequences, and the failure to pay resulted in a constructive dividend to Long, leading to a tax deficiency.

Facts

William R. Long was the chief executive officer and controlling shareholder of Long Mfg. N. C. , Inc. (Manufacturing) and the sole shareholder of Long Specialty Co. , Inc. (Specialty). Both companies used the accrual method of accounting. Following an IRS examination for 1981, income was allocated from Specialty to Manufacturing under section 482. A closing agreement was executed, allowing the companies to elect relief under Rev. Proc. 65-17. This required Specialty to pay Manufacturing $717,084. 93 within 90 days after the agreement's execution. Manufacturing offset part of this amount against an existing account payable to Specialty, but the remaining balance was not paid in cash or by note within the required period.

Procedural History

The IRS determined a tax deficiency against Long for 1981 and issued a statutory notice. Long petitioned the U. S. Tax Court, which upheld the IRS's position that the terms of the closing agreement were not met, resulting in a constructive dividend to Long.

Issue(s)

1. Whether the terms of the closing agreement requiring payment within 90 days were complied with by Specialty.
2. Whether the failure to pay the remaining balance within the 90-day period resulted in a constructive dividend to Long.

Holding

1. No, because Specialty did not make an actual payment in cash or issue a written obligation within 90 days as required by the closing agreement and Rev. Proc. 65-17.

2. Yes, because the failure to pay resulted in the unpaid balance being treated as a constructive dividend to Long, as stipulated in the closing agreement.

Court's Reasoning

The court emphasized that closing agreements are contracts governed by general contract principles and are final and conclusive as to all matters contained within them. The agreement clearly required payment in "United States dollars" within 90 days, which was not met by Specialty. Rev. Proc. 65-17, which the agreement was subject to, similarly required payment in the form of money or a written obligation. The court rejected the argument that a constructive payment was sufficient, noting that Rev. Proc. 65-17 must be narrowly construed as a relief provision. The court also dismissed the argument of inconsistency in allowing an offset against a pre-existing debt while requiring actual payment for the remaining balance, as the procedure itself allowed such offsets. The court concluded that substance must follow form, and actual payment was required to avoid tax consequences.

Practical Implications

This decision underscores the importance of strict compliance with the terms of closing agreements and IRS revenue procedures. Taxpayers relying on Rev. Proc. 65-17 must ensure actual payment within the specified time to avoid tax consequences of section 482 allocations. The ruling affects how taxpayers and their advisors handle such allocations, emphasizing the need for careful planning and timely execution of payments. Businesses with related entities must be aware of the necessity for actual transfers of funds to reflect income adjustments without triggering further tax liabilities. Subsequent cases have cited Long v. Commissioner to support the requirement for actual payment in similar situations involving section 482 and Rev. Proc. 65-17.

